



**UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION 8**

1595 Wynkoop Street
DENVER, CO 80202-1129
Phone 800-227-8917
<http://www.epa.gov/region08>

08/21/2023

Ms. Tina McFarling, P.E.
Program Administrator
Environmental Funding Program
Joe Foss Building, 523 E. Capitol
Pierre, SD 57501

Dear Ms. McFarling:

The U. S. Environmental Protection Agency (EPA) Region 8 has conducted an annual review of the South Dakota Drinking Water State Revolving Fund (DWSRF) for federal fiscal year 2022 (FY22) (October 1, 2021, through September 30, 2022), which matches the South Dakota state fiscal year, in accordance with EPA's SRF Annual Review Guidance.

The South Dakota Department of Agriculture and Natural Resources (DANR) manages the engineering and financial aspects of its DWSRF. As of September 30, 2022, the DWSRF operates as a direct loan program that episodically uses a cash-flow leveraging structure to sell additional bonds if warranted by project demand. Interest rates for FY22 loans typically ranged from zero percent to 2.125 percent, which included a 0.5 percent surcharge that is used for a wide range of activities, including operator certification training, state match, and paying state planning districts. DANR also operates a three-tier disadvantaged assistance program, which can provide extended financing up to 30 years at rates between zero and 1.875 percent.

The scope of the annual review includes consideration of the legal, managerial, technical, financial, and operational capabilities, and performance of the SD DANR in administering the DWSRF. EPA visited the state offices in Pierre, South Dakota during the week of June 5, 2023. Activities incorporated into the annual review included an analysis of the FY22 and FY23 Intended Use Plans (IUPs), audited financial statements, files for two projects (Joint Well Field, Inc and Groton), South Dakota financial indicators, and the following four cash draws:

FS998762-20; \$55,000; July 22, 2022
FS998762-20; \$900,000; May 06, 2022
FS998762-20; \$66,000; September 2, 2022
FS998762-21; \$114,100; June 28, 2022

Observations

The state of South Dakota managed its base DWSRF program in accordance with applicable statutes, regulations, and guidance. The EPA, Region 8, lists program observations below. Attached to this report is a table that shows each indicator in further detail.

In November 2021, the Bipartisan Infrastructure Law (BIL) was signed into law, which appropriated additional federal DWSRF funding for FY22-FY26 through three types of drinking water grants: BIL general supplemental, lead service line replacement and emerging contaminants. In March 2022, EPA issued BIL Implementation Guidance with the following FY22 allotments for South Dakota:

BIL General Supplemental: \$17,992,000
 Lead Service Line Replacement: \$28,350,000
 Emerging Contaminants: \$7,555,000

The FY23 allotments for South Dakota were issued on April 3, 2023, as follows:

BIL General Supplemental: \$21,055,000
 Lead Service Line Replacement: \$28,650,000
 Emerging Contaminants: \$7,640,000

Throughout the five years of BIL Implementation, EPA expects South Dakota to:

- Evaluate and revise, as needed, its DWSRF disadvantaged community criteria;
- Evaluate the DWSRF's priority point system for project ranking commensurate with need;
- Consider technical assistance funding; and
- Engage residents and community stakeholders in disadvantaged communities.

Unliquidated Obligations

The South Dakota DWSRF (as of September 30, 2022) has approximately \$16.6 million in unliquidated obligations (ULOs), which equals a 94 percent federal outlay expenditure rate. With the addition of BIL funding, a temporary increase in ULOs is expected. The state typically spends their DWSRF grant in approximately three years from the time of award, and currently the program is on track to continue this spending rate.

Additional Subsidy and Equivalency

In FY22, South Dakota has provided \$14.8 million in principal forgiveness. This total includes principal forgiveness awarded by the FY22 base, BIL general supplemental, and BIL emerging contaminant grants. To date, the program has awarded \$0.7 million from the FY22 grant, \$4.7 million from the FY22 BIL supplemental, and \$7.9 million from the BIL emerging contaminants grant in additional subsidy. The program has met the additional subsidy requirement for FY21 grant. For equivalency, South Dakota has met the both the FY22 base and BIL supplemental grant requirements.

DWSRF Project Progress

The DWSRF is summarized below (as of September 30, 2022), beginning with the following two tables. The first table presents DWSRF loan fund information and pace of construction, and the second table shows the state's set-aside expenditures.

TABLE I: DWSRF Program Summary (\$ millions)

DWSRF Funds Available for Projects	Project Assistance	Funds Use Rate	Project Disbursements	Pace of Construction

\$660.8	\$584.2	88%	\$526.5	90%
---------	---------	-----	---------	-----

TABLE II: DWSRF Set-Aside Summary (\$ millions)

Set-Aside	Set-Aside Amount	Amount Expended	% of Set-Aside Expended
Administrative	\$9.15	\$8.90	97%
Small System TA	\$4.10	\$3.99	97%
State Program	\$2.18	\$1.65	76%
Local Asst.	\$1.15	\$1.09	95%
TOTALS	\$16.58	\$15.63	94%

As of September 30, 2022, South Dakota's DWSRF *Fund Use Rate* was 88 percent. The remaining 12 percent of uncommitted funds equaled \$76.6 million. South Dakota's FY23 IUP included \$118.3 million on its fundable list, including a \$40.7 million project for Brookings, \$21.8 million for Clay Rural Water System, and \$12.5 million for Milbank. South Dakota's FY23 IUP identified sufficient uses for available DWSRF funds.

The *Pace of Construction* (disbursements divided by total project amounts) increased in FY22 from 88 percent to 90 percent, a good result. In FY22, the state disbursed \$41.1 million in construction expenses relative to \$6.4 million in federal cash draws, causing South Dakota's DWSRF *Federal Return* to increase from 2.12 to 2.23.

A key component of strategic SRF fund management is the balancing of cash inflows and outflows. The following ratio shows how efficiently South Dakota's DWSRF is revolving by examining the program's disbursement rate over a set time-period and comparing it to the amount of cash on hand. The ratio is calculated by subtracting total project disbursements (\$526.5 million) from total funds available (\$660.8 million) and comparing this number (\$134.3 million) to the average annual disbursements over the past three years (\$32.4 million). For the South Dakota DWSRF, this ratio is 4.15 (years), which is a slight increase from last year's ratio of 4.07, but is a strong accomplishment given the influx of BIL funds.

South Dakota DWSRF project milestones accomplishments are as follows as of June 30, 2022 (in \$ millions):

- Project Assistance: 351 projects at \$574.9
- Construction Starts: 331 projects at \$551.6
- Project Completions: 298 projects at \$422.9

South Dakota DWSRF's project completion dollar value as a percentage of assistance provided was 74 percent, 13 percent greater than the national DWSRF average of 61 percent. Overall, the South Dakota DWSRF is performing well in working with community water systems to complete drinking water

projects to further the goals of the Safe Drinking Water Act.

Financial Sustainability

Based on information from SRF Database, the South Dakota DWSRF had a *Net Return (not including Subsidy)* amount of \$27.8 million as of September 30, 2022, an annual increase of \$1.2 million. In FY22, the state collected \$4.2 million in interest payments and collected an additional \$2.8 million in interest earnings on investments and paid \$3.7 million in bond interest expense and repaid \$2.2 million in state match bonds.

The *Net Return on Contributed Capital excluding Subsidy* (contributed capital being the sum of federal grants plus deposited state match minus subsidy) was 10.39 percent, which was consistent with the previous year.

Total Net and Net Interest Margin

Total Net measures the extent by which internal growth is generating additional funding for new projects. This is calculated by taking the total cash inflows generated by ongoing loan and investment activity less bond repayments and interest payments. New federal capitalization grants are excluded from this calculation. For FY22, the South Dakota DWSRF's *Total Net* was \$6.3 million.

Net Interest Margin measures the percentage rate of return the SRF is generating from its total assets through loans and investments less bond interest expense. For FY22, the South Dakota DWSRF's *Net Interest Margin* was 1.08%, based on an annual net interest amount of \$3.4 million and an average of total assets of \$311.1 million and \$311.6 million at the beginning and end of FY22, respectively (average total assets calculated using the FY22 and FY21 total assets from the SD audited financial statements).

Financial Management and Proportionality

All four cash draws listed above were for eligible uses and were done at a correct federal proportion of 100 percent.

The South Dakota DWSRF shows sound financial health and management. The DWSRF has had no defaults and municipal loans are typically secured by revenues from user charges. The total net position as of June 30, 2022, was \$225.3 million, a near four percent increase over the FY21 net position of \$217.1 million.

For the year ending June 30, 2022, the South Dakota Department of Legislative Audit conducted an SRF financial statement and compliance audit on October 14, 2022, and the statewide single audit for South Dakota was completed on March 31, 2023. There were no findings/recommendations from either audit.

Set-Aside Use and DWSRF-PWSS Integration

SD DANR is making good use of its set-asides, using all four categories for DWSRF administration or technical assistance, and supporting its PWSS program. As of June 30, 2022, the *set-aside spending rate* was 96 percent.

The South Dakota DWSRF coordinates well with the South Dakota Drinking Water Program.

Prior Recommendations

There were no recommendations from last year's review.

New Recommendations

There are no new recommendations with this review.

The South Dakota DWSRF assessment has been completed by SRF Coordinator, Lindsey Phillips, in collaboration with the EPA Region 8 SRF team. If you have questions, you may contact Lindsey at Phillips.Lindsey.A@epa.gov or (303) 312-7291.

Sincerely,

Benjamin Bents
Branch Manager
Technical and Financial Services Branch

cc: Mr. Andy Bruels, P.E., Division Director